

DISCUSSION ON RELATED PARTY TRANSACTION ACCEPTANCE OF DEPOSIT LOANS AND ADVANCES

BY

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EFFECT OF NEW COMPANIES ACT

- Change from the **control based or regulatory regime to a disclosure based and transparent regime.**
- - No central government approval for related party transaction/ payment of higher salaries to person on holding post on place of profit, appointment of director more than 12, etc..



RELATED
PARTY
TRANSACTIONS



Related party

- Statutory provisions applicable
- Section 184(Disclosure), 188(Related party), 189 (register)
- Definition – ‘relative’, ‘related party, ‘Arm’s length transaction,
- The Companies (Meeting of board and its powers) Rule 2014
- CARO
- Accounting standards.



Definition of related Party

Section 2(76)



- (i) director or his relative;
- (ii) KMP or his relative;

- (iii) a firm, in which a director, manager or his relative is a partner;
- (iv) a private company in which a director or manager is a member or director;
- (v) a public company in which a director or manager is a director or holds along with his relatives, more than two percent of its paid-up share capital;

Shareholding less than two percent is not covered

- (vi) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
- (vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Not applicable to Private Limited companies

- (viii) any company which is-
 - (A) a holding, subsidiary or an associate company of such company; or
 - (B) a subsidiary of a holding company to which it is also a subsidiary;

- (i) such other person as may be prescribed.
A director or key managerial personnel of the holding company or his relative with reference to a Company shall be deemed to be a related party;

Relative of Directors

Section 2 (77) of Companies Act, 2013 defines the terms relative, person shall be deemed to be a relative of another only if,-

- 1) they are members of A Hindu Undivided Family; or
- 2) they are Husband & Wife; or
- 3) one is related to the other as may be prescribed

Prescribed relatives

- (1) Father:
- (2) Mother:
- (3) Son:
- (4) Son's wife.
- (5) Daughter.
- (6) Daughter's husband.
- (7) Brother:
- (8) Sister:

Transaction covered- Section 188

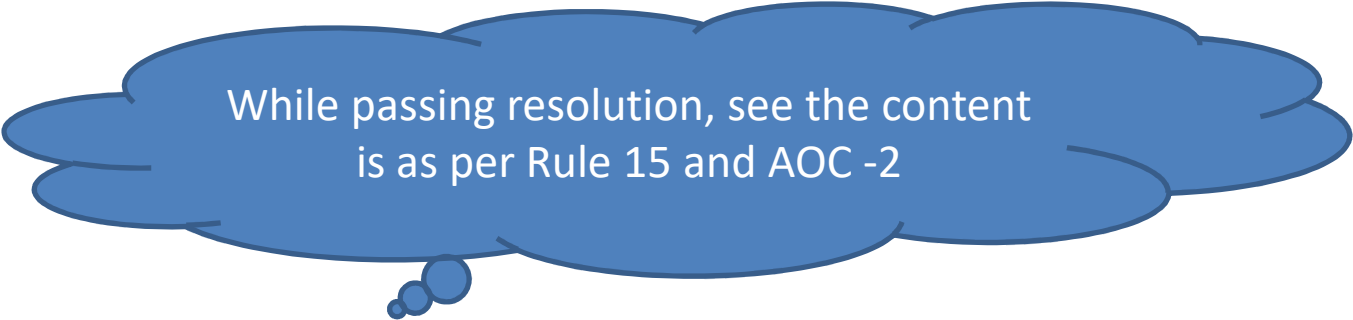
- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;
- (f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (g) underwriting the subscription of any securities or derivatives thereof, of the company:

Operative part of section

- Approval of Board in its properly conducted Board meeting subject to condition prescribed as under act.

THE COMPANIES (MEETINGS OF BOARD AND ITS POWERS) RULES, 2014

Rule 15. Agenda



While passing resolution, see the content is as per Rule 15 and AOC -2

More procedure

- In the case of a company having a paid-up share capital of Rs. 10 crores Or transactions exceeding following shall be entered with the prior approval of shareholder in the general meeting (instead of special resolution, now ordinary resolution is sufficient)

Instance of resolution in the general meeting

- (i) sale, purchase or supply of any goods or materials, directly or through appointment of agent, exceeding **ten per cent. of the turnover or rupees one hundred crore, whichever is lower,**
 - (ii) selling or otherwise disposing of or buying property, directly or through appointment of agent, **exceeding ten per cent. of the turnover or rupees one hundred crore, whichever is lower,**
 - (iii) leasing of property of any kind **exceeding ten per cent. of the net worth of the company or ten per cent. of turnover of the company or rupees one hundred crore, whichever is lower,**
 - (iv) availing or rendering of any services, directly or through appointment of agent, **exceeding ten per cent. of the turnover of the company or rupees fifty crore, whichever is lower,** as mentioned in sub-section (1) of section 177.
- (b) is for appointment of subsidiary company or **lakh rupees**
- (c) is for resolution for derivative

Exemption Dt.

05/06/2015- to private limited The members who are otherwise interest can now vote in general meeting

In case of approval of General meeting approval, Check minute book, MGT-7, AOC-4, Board report, Related party transaction AS-18

Legal paradox



- Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis

- Arm's Length Transactions and Related Parties.
- It means, to get rid of the applicability of the provisions of "Related Party Transactions", two conditions must be complied with:
 - a) the transaction is made in the ordinary course of business and
 - b) the transaction is made on arm's length basis.

- The phrase “ordinary course of business” is not defined under the Companies Act 2013 or rules made there under.
- It seems that the ordinary course of business will cover the usual transactions, customs and practices of a business and of a company.

- To decide whether an activity which is carried on by the business is in the “ordinary course of business”, the following factors may be considered:
 - a. Whether the activity is normal or otherwise unremarkable for your particular business (i.e. features in your systems, processes, advertising, staff training etc)
 - b. Whether the activity is frequent
 - c. Whether the activity is regular
 - d. What is the financial scale of activity with regard to operations of business
 - e. Revenue generated by the activity
 - f. Resources committed to the activity

- **Seksaria Biswan Sugar Factory v. Commissioner of Income-Tax, AIR 1950 Bom 200: (1950) 52 Bom. L. R. 91**
- In this case, the amount lent by the company to a third party was held as not to be in the ordinary course of business. The Court observed that just because an activity is included in the Memorandum of Association, the activity *per se* does not become an activity in the ordinary course of business of the company

- Following few examples of transactions are considered outside the entity's normal (or ordinary) course of business:
- Complex equity transactions, such as corporate restructurings or acquisitions.
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
- Sales transactions with unusually large discounts or returns.

- The assessment as to whether a transaction is in ordinary course of business, is very subjective, judgemental and can vary on case-to-case basis giving consideration to nature of business and objects of the entity

Poser

- X Limited has accepted deposits from Y Private Limited. Both Companies have common Directors. However, none of the Directors of Y Private Ltd hold more than 20% in X Ltd. Therefore Section 185 is not applicable. Y Private Limited is not a NBFC. Lending money is not its business. Since it had surplus funds and X Limited was in need of money, ICD was accepted by X Limited.

- Whether Y Pvt. Ltd. needs to comply with Section 188.
- Whether X Ltd. has to comply with Section 188.
- *In our view, the transaction does not fall under the scope of Section 188 since it is not a transaction with respect to any of the categories specified in sub section 1.*

- Explanation to the section “arm’s length transaction” means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest
- The methodologies and approaches for determining the “Arm’s Length Transactions” have not been prescribed in the Companies Act, 2013.

- In the absence of any information/methodology/approach for determining the “Arm’s Length Transaction” in the Companies Act, 2013, such methodologies/approaches existing under Transfer Pricing Guidelines” contained in the Income Tax Act, 1961 can be adopted.

- The arm's length price in relation to Transfer Pricing in an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely;
 - 1) Comparable Uncontrolled Price Method (CUP Method)
 - 2) Resale Price Method
 - 3) Cost Plus Method
 - 4) Profit Split Method
 - 5) Transactional Net Margin Method
 - 6) Such Other Method as may be prescribed by the Board

Poser

- Presuming transactions are not at arm's length and not in the ordinary course of business, whether following would be covered under services / related party transaction for the.
- 1. Payment of sitting fees to Director in the Board Meeting
 - *In our view, this is not a related party transaction envisaged by section 188 (1).*
- 2. Re-imbusement of expenses for attending Board Meeting
 - - *In our view, this is not a related party transaction envisaged by section 188 (1).*
- 3. Increase in the sitting fees
 - - *In our view, this is not a related party transaction envisaged by section 188 (1).*
- 4. Payment of guarantee commission
 - - *In our view, this is a related party transaction envisaged by section 188 (1) as it is availing a service rendered by the director to the company.*

- 5. Leave and Licence Agreement
- - *In our view, this is not a related party transaction envisaged by section 188 (1) since Section 188 (1) (c) covers only leasing of property of any kind.*
- 6. Remuneration to director for conducting in house training programmes in the company
- - *In our view, this is a related party transaction envisaged by section 188 (1) as it is availing a service rendered by the director to the company.*



FORM NO. AOC.2

(Pursuant to clause (h) of sub-section (3) of section 134 of the Act and Rule 8(2) of the Companies (Accounts) Rules, 2014)

Form for disclosure of particulars of contracts/arrangements entered into by the company with related parties referred to in sub-section (1) of section 188 of the Companies Act, 2013 including certain arms length transactions under third proviso thereto

1. Details of contracts or arrangements or transactions not at arm's length basis
 - (a) Name(s) of the related party and nature of relationship
 - (b) Nature of contracts/arrangements/transactions
 - (c) Duration of the contracts/arrangements/transactions
 - (d) Salient terms of the contracts or arrangements or transactions including the value, if any
 - (e) Justification for entering into such contracts or arrangements or transactions
 - (f) Date of approval by the Board
 - (g) Amount paid as advances, if any:
 - (h) Date on which the special resolution was passed in general meeting as required under first proviso to section 188
2. Details of material contracts or arrangement or transactions at arm's length basis
 - (a) Name(s) of the related party and nature of relationship
 - (b) Nature of contracts/arrangements/transactions
 - (c) Duration of the contracts/arrangements/transactions
 - (d) Salient terms of the contracts or arrangements or transactions including the value, if any:
 - (e) Date(s) of approval by the Board, if any:
 - (f) Amount paid as advances, if any:

Form shall be signed by the persons who have signed the Board's report.



- Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a special resolution in the general meeting under sub-section (1) *and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into*, such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, *the directors concerned shall indemnify the company against any loss incurred by it.*

Consequences of non compliance

- the following consequences shall ensue:-
- ii) In terms of Section 188(4) of the Act, the directors or other employees shall indemnify the company against any loss incurred by the company. In the event of company initiating any legal proceedings, i.e. suit for recovery of money in the court of law for claiming losses and damages, the directors shall be liable to pay the amount adjudicated and determined by the court.
- iii) A person shall not be entitled to be appointed as a Director by virtue of Section 164(1)(g) of the Companies Act, 2013 upon such director **being convicted of an offence dealing with related party transactions under Section 188 of the Act at any time during the preceding five years.**
- iv) In case of a listed company, both on directors and employee of company shall be liable to (a) imprisonment up to one year or fine up to Rs.5 lac but not less than Rs.25,000/- or both **(b) in case of company whose shares are not listed, fine up to Rs.5 lacs but not less than Rs.25,000/-.** However, there is no imprisonment prescribed.

Reporting under CARO

- ***13. In our opinion and according to the information and explanations given to us the Company is in compliance with Section 177 and 188 of the Act, where applicable, for all transactions with the related parties and the details of related party transactions have been disclosed in the standalone financial statements as required by the applicable accounting standards.***

poser

- In what circumstances is the prior approval of Board required for entering into specified contracts or arrangements with related parties under Section 188?
- The specified transaction entered not in ordinary course of business and at arm's length.

poser

- Can a director interested in the contract participate in the board meeting or be counted for quorum as per Section 174 of CA 2013?
- In case of private limited, the Directors after making disclosure can participate and counted for quorum.

poser

- Whether resolution by the Board or General meeting passed U/S 188 needs to file with ROC in case private Limited company.
- No , as the resolution is not special resolution.

Poser

- In case of appointment of son/ daughter/ wife/ husband or other relative in the company having salary of Rs. 100 per month, whether approval of Board is required.
- Yes
- *(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise*

Poser

- Whether for appointment of Managing Director who is relative of Director required approval US 188.
- No
- *(i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;*

AS-18

- Accounting Standard 18 about Related Party Disclosures defines
- the term 'related party' as:
- *“parties are considered to be related if at any time during the reporting period one party has the **ability to control** the other party or **exercise significant influence** over the other party in making financial and / or operating decisions.”*
- Thus, it can be seen from the definition that for the purposes of AS-18, the most important factor in deciding whether a party is related or not, is control or significant influence. Under AS-18, the terms 'control' and 'significant influence' are defined as below:

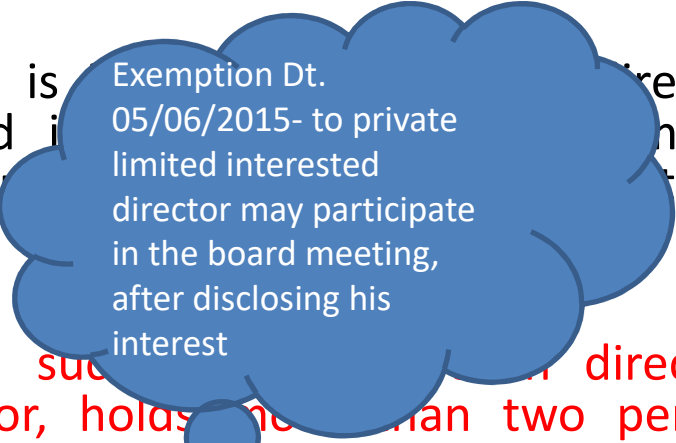
- Thus, while Companies Act 2013 gives a list of parties which may be said to be related parties with reference to a company, AS-18 refrains from making such a list. Whether a party is a related party or not for the purposes of AS-18 is decided on the facts of the case.



Section-184 (Disclosure of interest by director)

- Every director shall at the
- first meeting of the Board in which he participates as a director and
- thereafter at the first meeting of the Board in every financial year or
- whenever there is any change in the disclosures already made,
- disclose his concern or interest in **any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed**

Instance of disclosure

- Every director of a company who is directly or indirectly, concerned or interested in a proposed contract or arrangement entered into—

 - (a) with a body corporate in which such director in association with any other director, holds not more than two per cent. shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
 - (b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be,

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting:

- (3) A contract or arrangement entered into by the company without disclosure under subsection (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

- 4) If a director of the company contravenes the provisions of sub-section (1) or sub-section (2), such director shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

Exception

- Nothing in this section applies when
- (b) shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than two per cent. of the paid-up share capital in the other company.

Treatment of Related Party Transactions

- Section 40a(2)(b) of the Income Tax Act disallows the expenditure incurred in relation with specified persons (Related Parties), if assessing officer is in the opinion that the expenditure is excessive & unreasonable with respect to fair market value of goods, services or facilities used. -

REPORTING UNDERCARO

- Whether the Company has granted any loans, secured or unsecured, to companies, firms, limited liability partnerships or other parties covered in the register maintained under Section 189 of the Act.

Register us 189

- Every company shall keep registers (MBP-4) for
 - particulars of all contracts or arrangements to which sub-section (2) of sections 184 or
 - section 188 applies,
 - shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.
-
- (2) Every director within a period of thirty days of his appointment, or relinquishment of his office, as the case may be, disclose to the company.

(5) Nothing contained in sub-section (1) shall apply to any contract or arrangement

(a) for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the **cost of such services does not exceed five lakh rupees in the aggregate in any year; or**

(b) by a banking company for the collection of Acts in the ordinary course of its business.

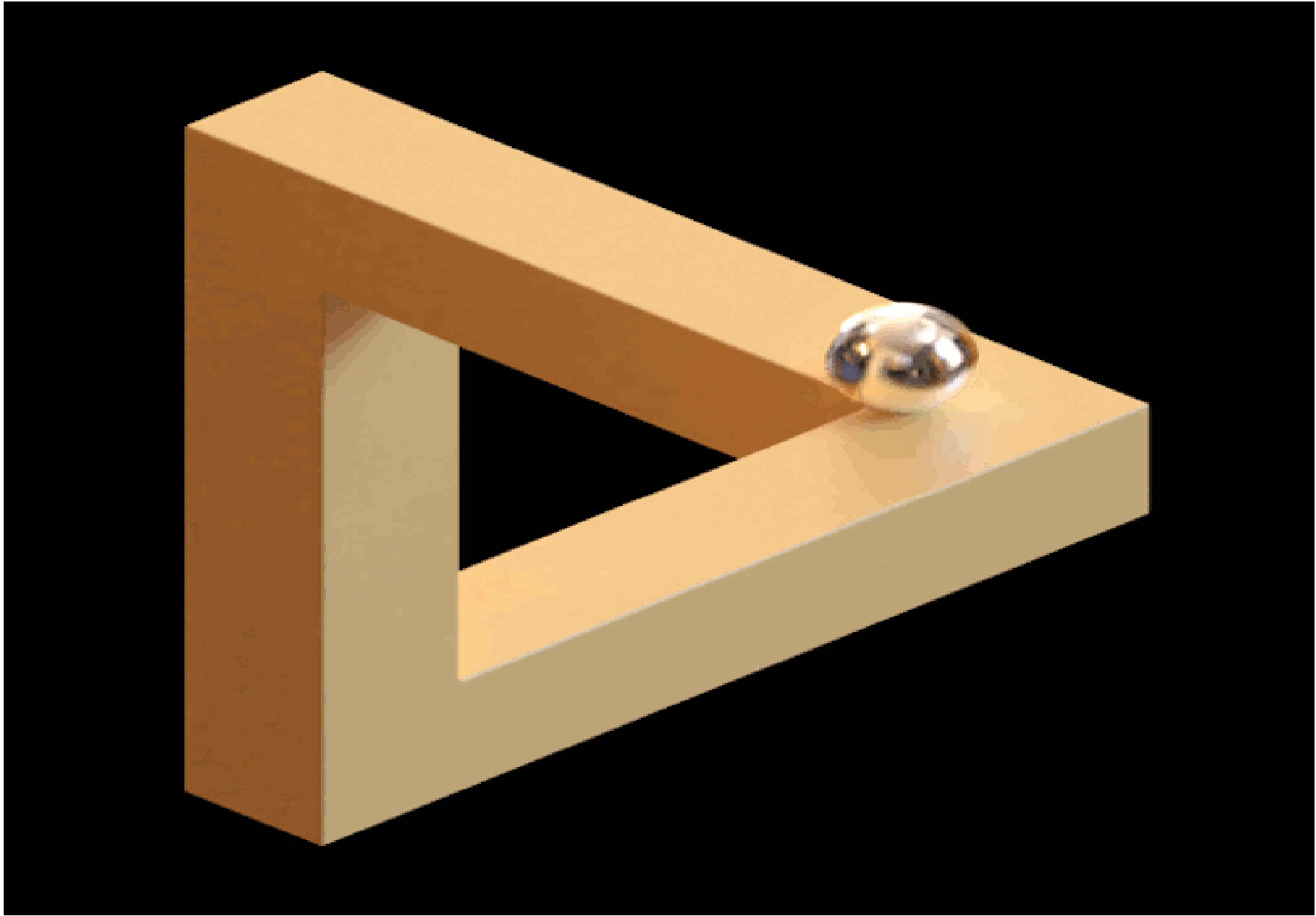
POSER

- Whether for transaction which in ordinary course of business and is at arm's length entry is required to be made in register maintained us 189.
- No as provision of section 188 is not applicable.

POSER

- Can a company have register its register u/s 189 be totally blank .
- As far as section – yes, as far as rules – no.

**ACCEPTANCE
OF
DEPOSITS**



Applicable statutory provision

- Section 73 to 76 of the Companies Act, 2013
- Companies (Acceptance of Deposits) Rules, 2014.
- Notification/ circular
- Reporting under CARO
- NCLT cases.

Definition of Depositor

- (i) any member of the company who has made a deposit with the company in accordance with sub-section (2) of section 73 of the Act, or
- (ii) any person who has made a deposit with a public company in accordance with section 76 of the Act

Definition of deposit

- Rule 2 (c) Companies (Acceptance of Deposits) Rules, 2014 defines the term deposit in



and excludes



XIV Paras



- (i) any amount received from the Central Government
- (ii) any amount received from foreign Governments
- (iii) any amount received as a loan or facility from bank
- (iv) any amount received as a loan or financial assistance from Public Financial Institutions
- (v) any amount received against issue of commercial paper
- (x) any amount received from an employee not exceeding his annual salary, under a contract of employment with the company in the nature of non-interest bearing security deposit;
- (xi) any non-interest bearing amount received or held in trust;
- (xiv) any amount accepted by a Nidhi Company in accordance with the rules made under Section 406 of the Act.
- (xv) any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982
- (xvi) any amount received by the company under any collective investment scheme in compliance with regulations framed by the Securities and Exchange Board of India;

(vi) any amount received by a company from any other company;


(vii) any amount received as share application money- appropriate the same against share capital – if not appropriate within 60 days – refund in more 15 days – otherwise it will be deposit.

- **For the purpose of this rule any adjustment of the amount for any other purpose will not be treated as refund**





(viii) any amount received director and its relatives .



(ix) any amount raised by the issue of bonds or debentures secured by a first charge or pari passu with the first charge on any assets or bonds / debentures compulsorily convertible into shares of the company within ten years.



- any amount received
- (a) as an advance -----supply of goods or provision of services provided -----appropriated within a period of three hundred and sixty five days – except legal cases.
- (b) as advance-----in connection with consideration for imovable property under an agreement or arrangement, provided that such advance is adjusted against the property in accordance with the terms of agreement or arrangement.
- (c) as security deposit for the performance of the contract for supply of goods or provision of services.
- (d) as advance -----long term projects or for supply of capital goods.
- (e) as an advance towards consideration for providing future services in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;
- (f) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;
- (g) as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications



Terms & Conditions



- any amount brought in by the **promoters** by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank - conditions:-
 - (a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance; and
 - (b) the loan is provided by the promoters themselves or by their **relatives** or by both; and
 - (c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter

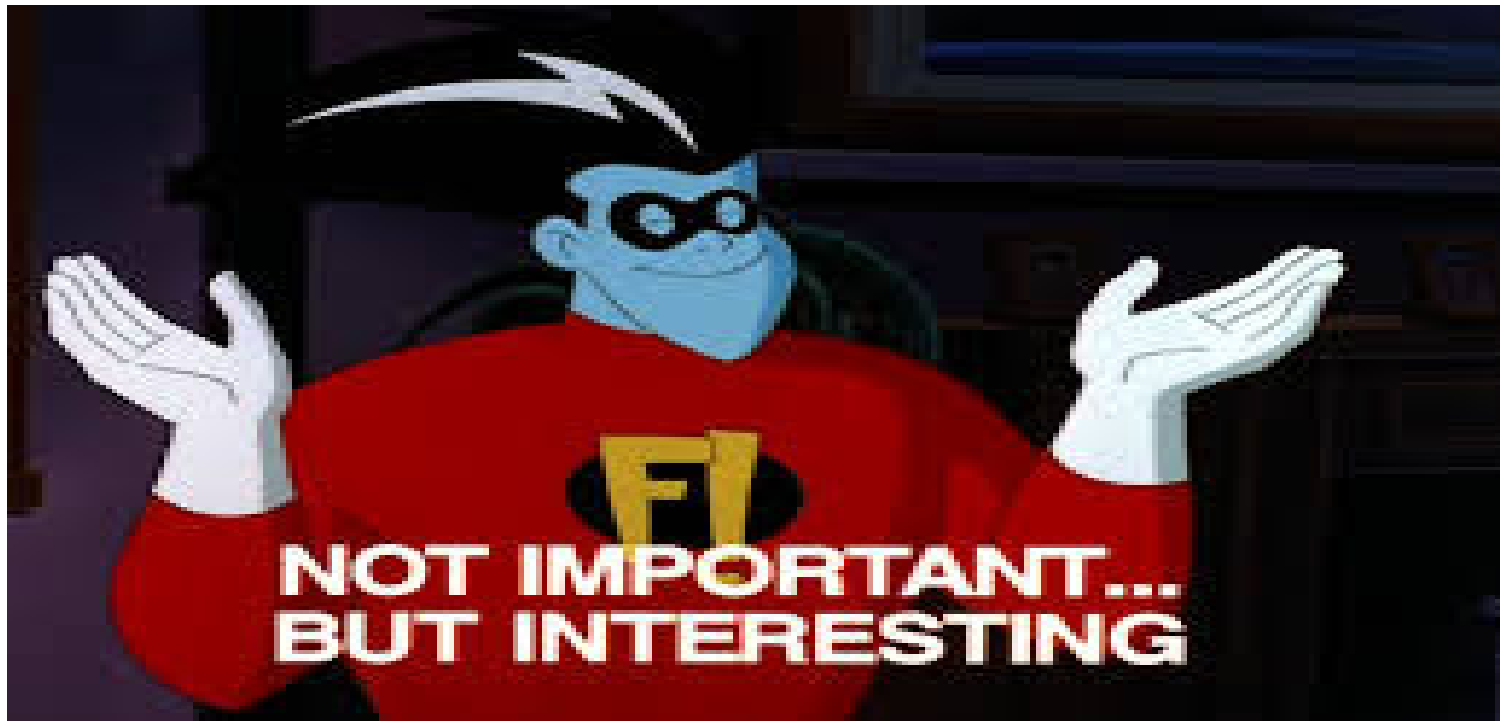
Start- Up

- an amount of **twenty five lakh rupees** or more received by a start-up company, by way of a convertible note (convertible into equity shares or repayable within a period not exceeding five years from the date of issue) in a single tranche, from a person
- start-up company" means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification number G.S.R. 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;

Who is an Eligible Company

- having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees

Conditions for acceptance of deposit





Who can accept Deposits?

A company other than eligible company
(sec 73(2))

Eligible Company

It means a public Company having a –
Net worth of 100 cr or more
or
Turnover of 500 cr or more

TERMS AND CONDITIONS

Conditions for accepting deposits by Companies

- Need to pass a resolution in general meeting
- Shall not accept deposit for less than 6 months and more than 36 months (3 yrs) from the date of acceptance
- Shall not accept or invite or renew any deposit carrying a rate of interest exceeding the maximum rate of interest prescribed by RBI
- Does not have the right to alter the terms and conditions of deposit.



LIMITS FOR ACCEPTING DEPOSITS

Companies other than Eligible Co.

- Amount of deposit together with outstanding deposit amount shall not exceed 25% of paid up share capital & free reserves of the company

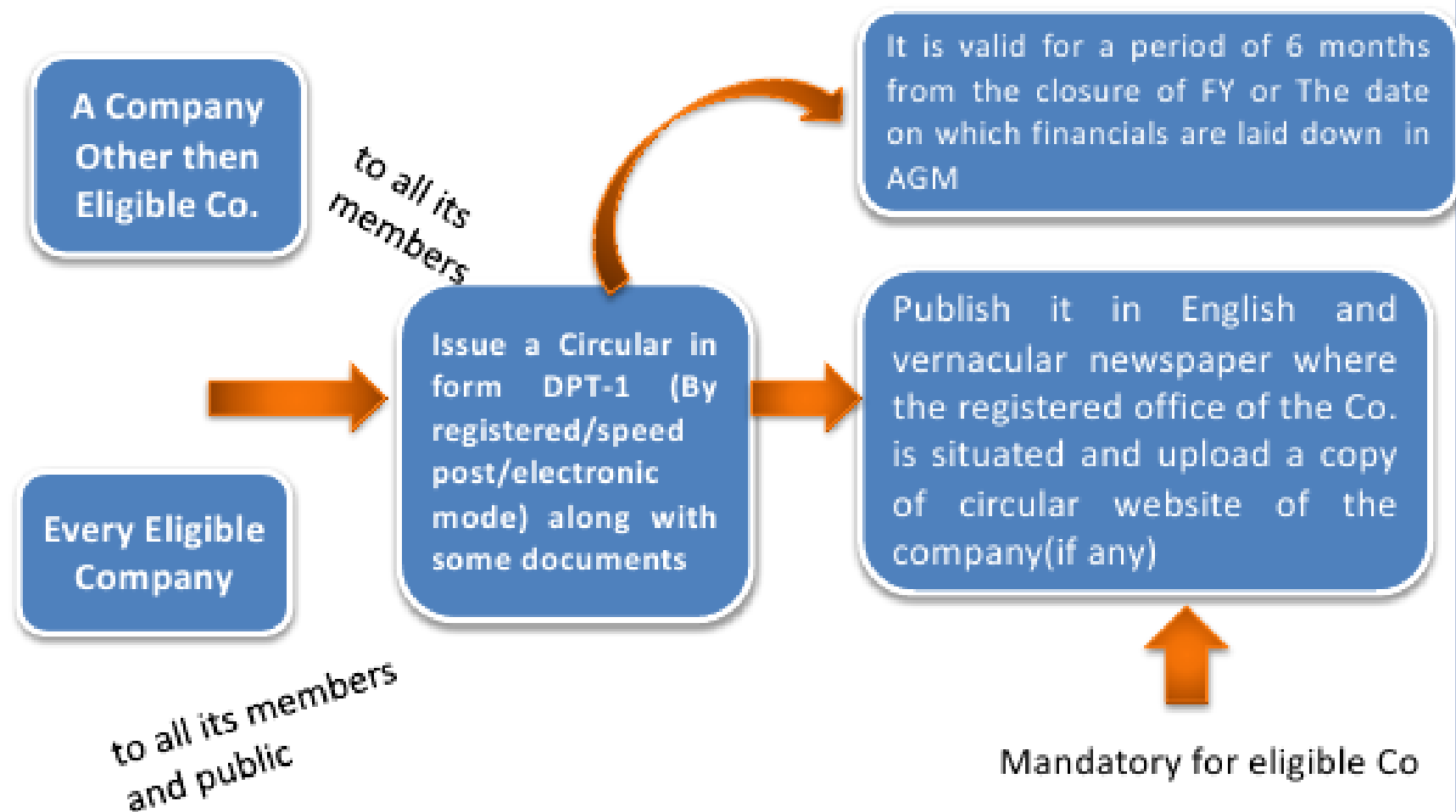
Eligible Company

- Shall not accept deposits from :-
 - 1) **its members** if the amount of deposit together with outstanding deposits amount exceeds 10% of paid up share capital & free reserves of the company
 - 2) **others**, if the amount of deposit together with outstanding deposits amount (other than above) exceeds 25% of the paid up share capital & free reserves of the company

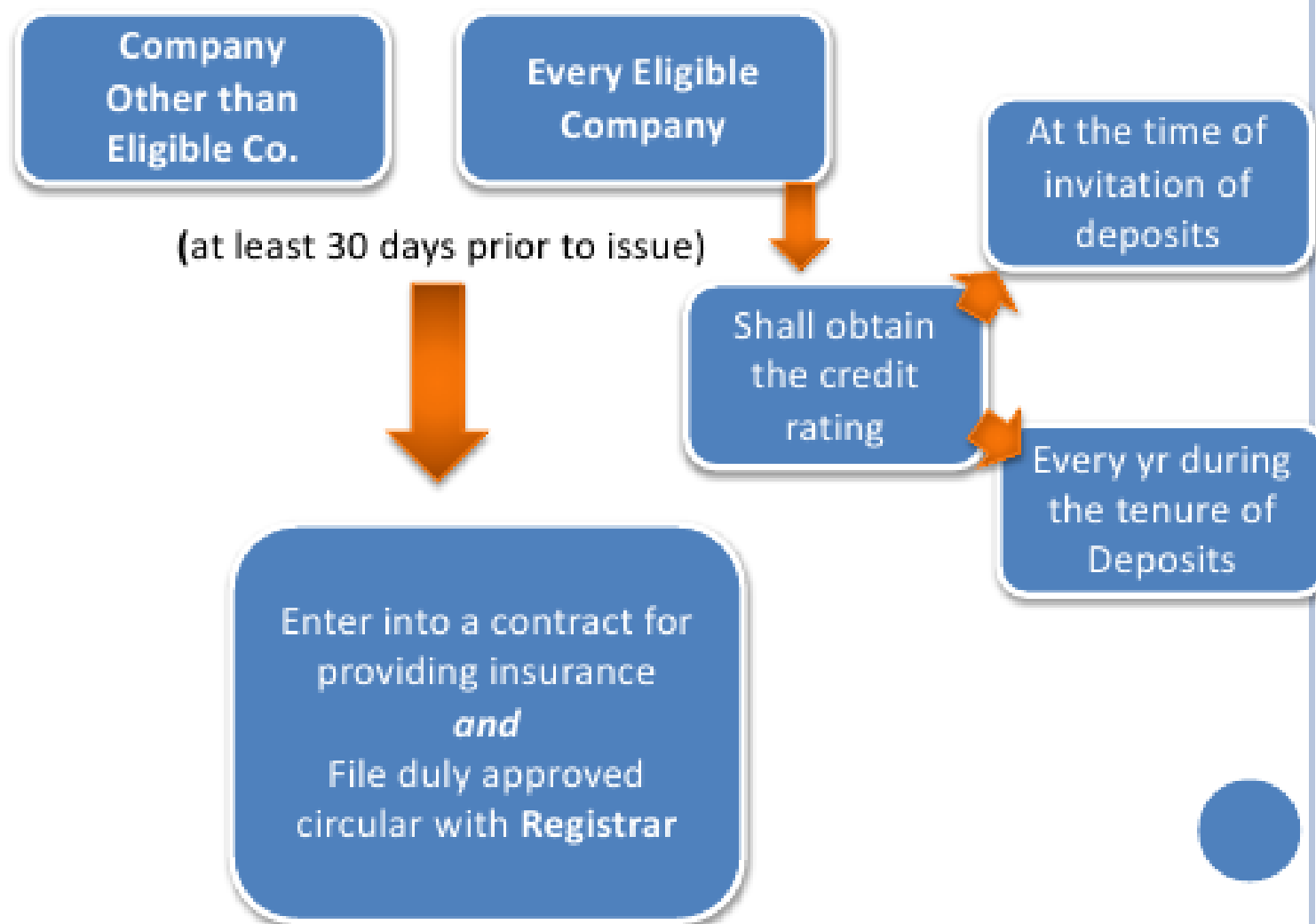
Government Company

- Amount of deposit together with outstanding deposit amount shall not exceed 30% of paid up share capital & free reserves of the company

FORMS AND PARTICULARS OF ADVERTISEMENT /CIRCULAR



OTHER IMPORTANT CONDITIONS



FESTIVE OFFERS

ANNAPURNA ATTA 5kg

~~MRP. 165/-~~

Rs. **164.90/-**
ONLY

Exemption from provision of deposits

- Exemption as on 05/06/2015
- Chapter V, clauses (a) to (e) of sub-section (2) of section 73. – Shall not apply to a private Company which accepts from its members monies **not exceeding one hundred per cent. of aggregate of the paid up share capital and free reserves**, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified

PAST

- Section 74(1) states provision for deposit accepted by a company before the commencement of this Act.
 - file, within a period of three months from such commencement – with Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment
- (b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Clarification – general circular dt. 30.03.2015

Stakeholders have sought clarifications as to whether amounts received by private companies from their members, directors or their relatives prior to 1st April, 2014 shall be considered as deposits under the Companies Act, 2013 as such amounts were not treated as 'deposits' under section 58A of the Companies Act, 1956 and rules made thereunder.

2.The matter has been examined in consultation with RBI and it is clarified that such amounts received by private companies prior to 1st April, 2014 shall not be treated as 'deposits' under the Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 subject to the condition that relevant private company shall disclose, in the notes to its financial statement for the financial year commencing on or after 1st April, 2014 the figure of such amounts and the accounting head in which such amounts have been shown in the financial statement.

3. Any renewal or acceptance of fresh deposits on or after 1st April, 2014 shall, however, be in accordance with the provisions of Companies Act, 2013 and rules made thereunder.

Disclosure as per Rule

- **16A. Disclosures in the financial statement. -**
- (1) Every company, other than a private company, shall disclose in its financial statement, by way of notes, about the money received from the director.
- (2) Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.”

Disclosure in CARO

- 5. The Company has not accepted deposits during the year and does not have any unclaimed deposits as at March 31, 2017 and therefore, the provisions of the clause 3 (v) of the Order are not applicable to the Company.

Remedies for depositors

- NCLT
- class action-Section 245 (1) (g) As per Section 245(1)(g)
Depositor may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the depositors for seeking orders including claiming damages or compensation or demand any other suitable action from or against
- Against the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

Conclusion

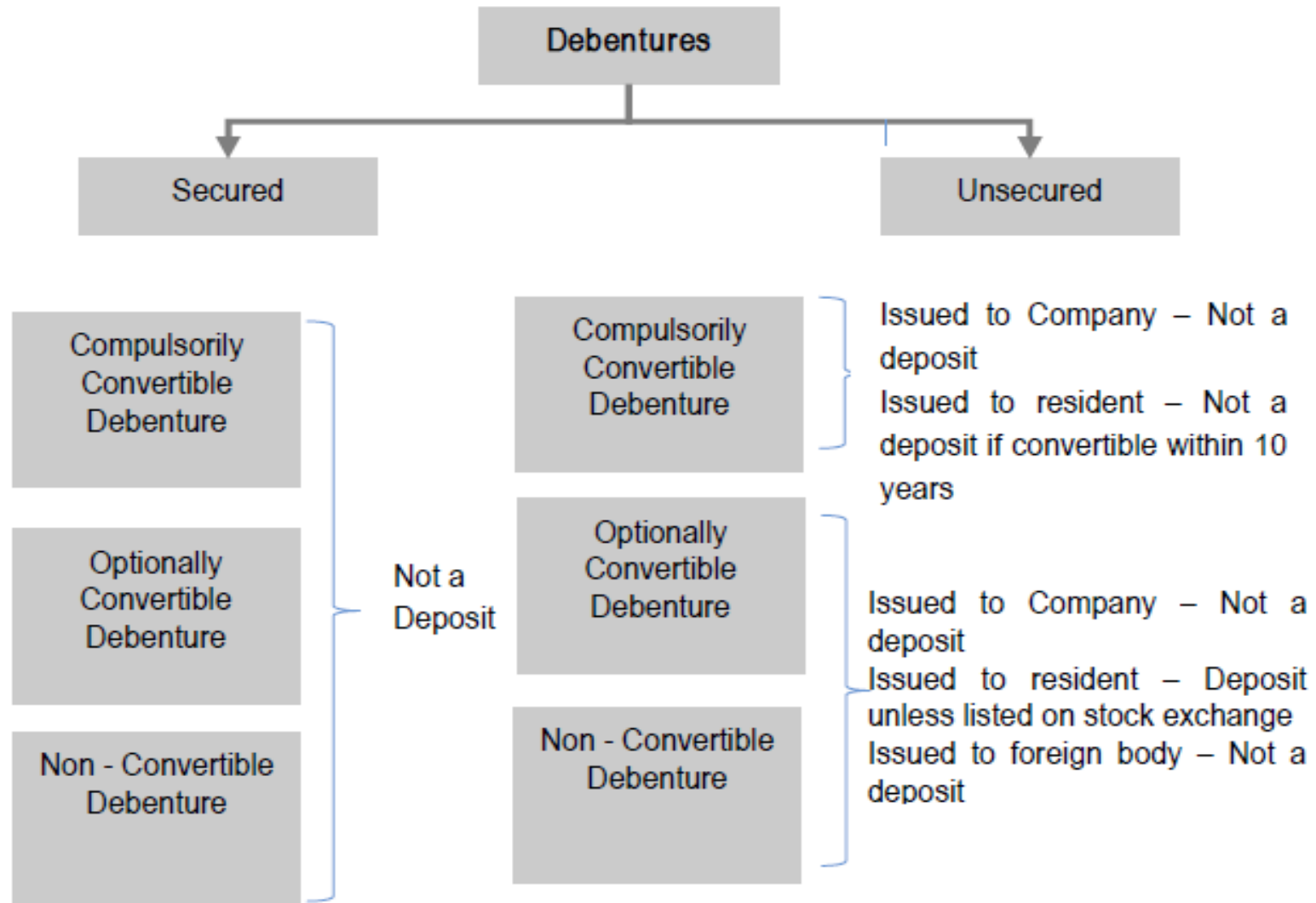


- Can a Private Company accept deposit from its members without complying with the provisions applicable to deposits?

- Yes, as per the exemption Notification No. GSR 464(E) of the MCA dated 5th June 2015

- Does Deposit provisions cover debenture

Deposits



- Will advance towards annual maintenance service for more than 365 days be treated as a deposit?
- Is share application money pending allotment for more than 60 days treated as a deposit?
- Whether advance taken from customers by real estate company on which no interest has been paid will be treated as advance or deposit as per the Companies Act, 2013?

LOANS, ADVANCE AND INTEROPERATE LOANS

LOAN TO OTHER COMPANY (INTER CORPORATE LOAN)

- Sections Involved:
- Section 185: Restriction on Loan to Director or other persons include in Director.
- Section 186: Company can directly or indirectly (a) give any loan to any person or other body
- Section 187: Investment of the Company to be held in its own name.
- Section 117(3) (a): Every special resolution and resolution passed under Section 179 required to file in e-form MGT-14.
- Section 179(3): The Board of directors of the Company can investments the fund of Company.

LOANS TO DIRECTORS

Section 185

(Notified w.e.f. 12.9.2013)

(iv) Compliance of Section 185 and 186 reporting under CARO

:

- In our opinion and according to the information and explanations given to us, the Company has complied with the provisions of Sections 185 and 186 of the Act in respect of grant of loans, making investments and providing guarantees and securities, as applicable.
- While doing Bank audit, check the compliance of section 185 in case of group companies loan/ guarantee case.

What are the prohibitions on Sec 185?

- ❑ No company can directly or “indirectly” advance loan to its “directors” or to “other persons in whom directors are interested”.
- ❑ • No company can give any guarantee or provide any security in connection with any loan taken by him or such other person.
- ❑ • Company can't give loan represented by a book debt to above mentioned person”.

Person covered

- Directors
- Other person in whom Director is interested.
 - Directors of holding company
 - Partner of Director
 - Relative of Director
 - Partnership firm in which Director/relative is partner
 - Private Limited in which Director is Director or member
 - Body corporate in which 25% or more is controlled by Directors
- Covers Loan, guarantee & Security.

Whether LLP
is also
covered?

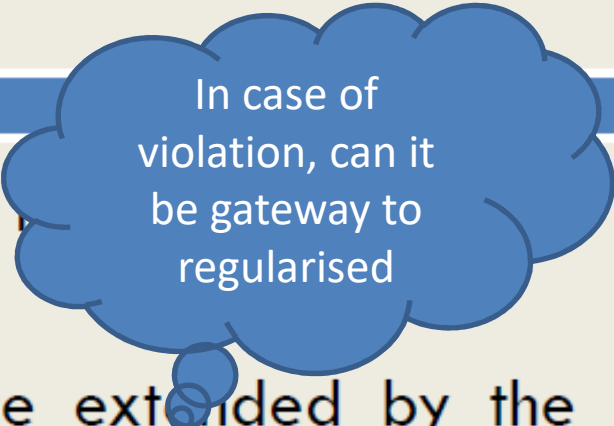
Shareholding
of relative is
not covered
is not
covered

Company in
which
relative is
Director /
member is
not covered

- Loan to private Limited in which Directors relative are Directors and members is not covered.
- Loan to Limited company in which Director is having less than 25 % shareholding is also not covered

What are the exceptions to sec 185?

- a) MD/WTD - The giving of any loan by a Whole-time director-
- (i) as a part of the conditions of service extended by the company to all its employees; or
 - (ii) Pursuant to any scheme approved by the members by a special resolution;
- b) ORDINARY COURSE - A company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by RBI.



In case of violation, can it be gateway to regularised

Exemption to holding subsidiary

- Transactions amongst holding **and wholly owned** subsidiary Company with regard to:-
 - **Any loan made** by a holding company to its wholly owned subsidiary company or;
 - **Any guarantee** given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company and
- **Transactions amongst holding and subsidiary Company**
 - **Any guarantee given or security** provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary Company;
- wherein such loans are utilised by the subsidiary Company (including wholly owned subsidiary) for its principle business activities.

Exemption to Private Limited company

- Chapter XII, section 185. – Shall not apply to a private
- company –
- (a) in whose share capital no other body corporate has invested any money;
- (b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees whichever is lower; and
- (c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section.

General Circular No. 04/2015

No. 1/32/2013-CL.V
Government of India
Ministry of Corporate Affairs

5th floor, 'A' wing, Shastri Bhavan
New Delhi – 110001
Dated: 10/03/2015

To

All Regional Directors,
All Registrar of Companies,
All Stakeholders.

Subject : Clarification with regard to section 185 and 186 of the Companies Act, 2013 – loans and advances to employees - reg.

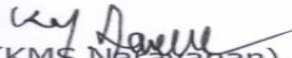
Sir,

This Ministry has received a number of references seeking clarification on the applicability of provisions of section 186 of the Companies Act, 2013 relating to grant of loans and advances by Companies to their employees.

2. The issue has been examined and it is hereby clarified that loans and/or advances made by the companies to their employees, other than the managing or whole time directors (which is governed by section 185) are not governed by the requirements of section 186 of the Companies Act, 2013. This clarification will, however, be applicable if such loans/advances to employees are in accordance with the conditions of service applicable to employees and are also in accordance with the remuneration policy, in cases where such policy is required to be formulated.

3. This issues with the approval of the Secretary.

Yours faithfully,


(KMS Narayanan)
Assistant Director

Phone : 011-23387263

Conv to :

Violation

- the company shall be punishable with fine which shall not be less than **five lakh rupees but which may extend to twenty-five lakh rupees,**
- and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to **six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.**

LOANS, GUARANTEES AND INVESTMENTS

Section 186

What types of specified transactions are covered under the Section?

9

Section 186 covers 3 types of specified transactions entered into by a company directly or indirectly:

- a) Loans to any person or other body corporate;
- b) Guarantee or security given in connection with a loan to any other body corporate or person; and
- c) Acquisition by way of subscription, purchase or otherwise, the securities of any other body corporate.

What is the ceiling on the specified transactions that Board of Directors of a company can enter into?

Board of Directors of a company can approve transactions as specified above if the aggregate of all such existing and proposed transactions does not exceed higher of the following two limits:

- a) 60% of its paid-up share capital, free reserves and securities premium account; or
- b) 100% of its free reserves and securities premium account.

What if the ceiling of the specified transactions exceeds above limit?

Prior approval of shareholders by way of special resolution is required in case the above limit is exceeded.

However, as per Rule 11 of Companies (Meetings of Board and its powers) Rules 2014 this will not be applicable in case of specified transactions entered into by a holding company with its wholly owned subsidiary company or to a loan or guarantee given or security provided by a company to a joint venture company.

What types of companies are covered under the Section?

- Section 186 is applicable to all types of companies including private limited companies irrespective of their size.

Whether various advances and deposits will also be covered under the Section?

31

There is a difference between advance and loan. Loan is lending of money with absolute promise to repay whereas advances is to be adjusted against supply of goods and services.

Genuine trade advances given to suppliers against orders for supply of goods will not be considered as loans and hence will be out of purview of Section 186.

Similarly, advances given to employees against current month's salary will also not be in the nature of loans.

- posers

- What disclosure need to do in case of section 186.
- Section 186(4)
- For loans, guarantee or security- the company shall disclose in its financial full particulars of such loan, guarantee or security and the purpose for which said loan, guarantee is propose to utilized.

- What is mode of resolution required to be passed for investment in other Company
- Board Resolution if, investment within the limit mentioned under Section 186
- Special Resolution if, investment outside the limit mentioned under Section 186

- Which form required filing for investment in other Company.
- In case of Passing of Board Resolution: MGT-14 required to file by all the Companies except Private Limited Company
- In case of Passing of Special Resolution: MGT-14 required to file by all the Companies

- Whether a company can give interest-free loan- no, it will hit section 186.
- No company can give loans at rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

General Circular 06/2015 dated 9th April, 2015

- It is hereby clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan, there is no violation of sub-section (7) of section 186 of the Companies Act, 2013

- Whether there is any other restriction on entering into specified transactions by a company?
- No company which is in default in the repayment of any deposits
- Company cannot give loan for purchase of its own shares (Section 67).
- Section 2(22)(e) of Income Tax Act 1961 which provides that even loan can be deemed to be dividend in certain cases –
- RBI Act (for provisions relating to NBFC)

- Which register need to be maintained.
- Particulars of loans/guarantees/security/investments to be entered into register maintained for this purpose at the registered office, which shall be open for inspection and extracts may be taken by members on payment of prescribed fee.

Circular 15/2014 dated 9th June, 2014

- It is hereby clarified that registers maintained by Companies pursuant to sub-section (5) of Section 372A of Companies Act, 1956 may continue as per requirements under these provisions and the new format prescribed vide form MBP2 shall be used for particulars entered in such registers on and from 1.4.2014.

Have a
fantastic
I do

